

DISCLAIMER

This electronic version of an SCC order is for informational purposes only and is not an official document of the Commission. An official copy may be obtained from the [Clerk of the Commission, Document Control Center](#).

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, APRIL 11, 2001

APPLICATION OF

APPALACHIAN POWER COMPANY
d/b/a AMERICAN ELECTRIC POWER-
VIRGINIA

CASE NO. PUE010011

For approval of a Functional Separation
Plan under the Virginia Electric Utility
Restructuring Act

ORDER FOR NOTICE AND HEARING

On January 3, 2001, the Appalachian Power Company d/b/a American Electric Power – Virginia (hereafter "AEP-VA" or "the Company") filed with the Virginia State Corporation Commission ("the Commission") an application pursuant to Virginia Code § 56-590 B of the Virginia Electric Utility Restructuring Act ("Restructuring Act" or "the Act") and under §§ 56-88 through 56-92 of the Utility Transfers Act ("Transfers Act").¹ Virginia Code § 56-590 B requires each incumbent electric utility to submit a plan for, and the Commission to direct, the functional separation of the utility's generation, retail transmission and distribution assets and operations. AEP-VA's application, inter alia, seeks approval of a plan for the corporate separation of the Company's generation, transmission, and distribution functions (the "Plan").

In brief, AEP-VA seeks the Commission's approval of its proposed plan for the corporate separation of its generating assets and operations from its transmission and distribution assets and

¹ Chapter 5 (§ 56-88, et seq.) of Title 56 of the Code of Virginia.

operations. The Plan further requests the Commission to make certain determinations called for under the Public Utility Holding Company Act ("PUHCA")² with respect to the proposed separation. In addition, the Company proposes that if it is unable to proceed with the corporate separation plan as set forth in its application, it may effect an alternative corporate restructuring whereby the transmission and distribution assets and operations would be transferred out of AEP-VA, while AEP-VA would retain the generation assets and operations. Finally, the Company seeks the Commission's approval of AEP-VA's proposed Standard Tariff and Open Access Distribution Tariff.

Corporate Separation

As part of its proposed corporate separation plan, AEP-VA is forming Genco, a non-regulated affiliate generation company. AEP-VA will transfer to Genco all generation-related operations and related assets owned or held by AEP-VA and its subsidiaries. In return, stock of Genco will be distributed to AEP-VA. All existing debt of AEP-VA would remain the obligation of AEP-VA until the post-transfer capital structures of AEP-VA and Genco are established. Genco plans to own and operate the generating assets transferred to it by AEP-VA as an exempt wholesale generator or EWG, not subject to regulation by the Commission. The electric transmission operations and related assets and liabilities and the electric distribution service operations and related assets and liabilities will be functionally separated from each other but will be retained by the Company.

AEP-VA then intends to make a tax-free distribution of the stock of Genco to American Electric Power Company, Inc. ("AEP"), AEP-VA's corporate parent. Genco would then become a subsidiary of Holdco, a proposed first-tier, wholly-owned subsidiary of AEP. According to the

² 15 U.S.C.A. §§ 79 through 79z-6 (1997).

Company, Holdco will be the parent of the AEP subsidiaries whose revenues will be derived from competitive activity, while AEP-VA would become a subsidiary of Regco, a first-tier, wholly-owned company of AEP. It is proposed that Regco will hold utility subsidiaries that are subject to regulation as to rates and tariffs.

At the conclusion of the transactions described above, if and when approved, AEP-VA would continue to own all of the distribution and bulk power transmission facilities it now owns and would be responsible for the performance of distribution and transmission operations either directly or through previously approved affiliates arrangements. According to the Company, AEP-VA would operate its transmission and distribution facilities as functionally separate business units.

The Company also proposes that its capped rate obligations under § 56-582 and potential default service obligations under § 56-585 to Virginia retail jurisdictional customers would be satisfied through purchase power arrangements between AEP-VA and Genco and/or other affiliates. In addition, AEP-VA proposes to collect any wires charges due under § 56-583 during the capped rate period.

AEP-VA has requested that this Commission make certain findings under PUHCA related to its intention to have Genco treated as an EWG. Under PUHCA, an EWG's generation assets are denominated "eligible facilities." According to the Company, PUHCA requires, under 15 U.S.C.A. § 79z-5a(c) (1997) thereof, that as a prerequisite to the treatment of AEP-VA's generating facilities as "eligible facilities" utilized by an EWG in the wholesale market, and no longer subject to regulation by the

Virginia State Corporation Commission, this Commission must determine that such treatment (i) will benefit consumers, (ii) is in the public interest, and (iii) does not violate state law.³

The Company is also asking for additional Commission findings under PUHCA. These findings relate to any proposed wholesale purchased power agreement between AEP-VA and Genco. As noted by the Company in its application, if Genco qualifies for treatment as an EWG, then, because Genco will be an affiliate of AEP-VA, federal law prohibits AEP-VA and Genco from entering into a wholesale power purchase agreement unless this Commission finds that it has sufficient regulatory authority, resources, and access to books and records of AEP-VA and any relevant associate, affiliate, or subsidiary company to exercise its duties under 15 U.S.C.A. § 79z-5a(k)(2) (1997). Those duties, imposed upon the Commission by federal law, require the Commission to determine that the proposed transaction: (i) will benefit consumers; (ii) does not violate any state law (including where applicable, least cost planning); (iii) would not provide Genco any unfair competitive advantage by virtue of its affiliation or association with AEP-VA; and (iv) is in the public interest.

It should be noted that AEP has not received approval from the United States Securities and Exchange Commission ("SEC") to form the proposed entities described as Genco, Holdco and Regco, (shown on the Plan's Exhibit C-3). Thus, the Company states that it is unable to furnish (i) the legal names and structure of Genco, Holdco or Regco; (ii) the location and mailing addresses of the

³ As noted by the Company on pp. 4 and 5 of its Plan, an EWG must be directly (or indirectly through an affiliate as defined in 15 U.S.C.A. § 79b(a)(11)(B)) and exclusively engaged in the business of owning and/or operating "eligible facilities" and selling electric energy at wholesale. 15 U.S.C.A. § 79z-5a (a)(1). An "eligible facility" is a facility used exclusively for the generation of electricity for sale at wholesale or used for the generation of electricity and leased to one or more public utility companies. 15 U.S.C.A. § 79z-5a (a)(2). Moreover, because the generating facilities to be transferred to Genco were in the rate base of AEP-VA on the date that section 32 of PUHCA, 15 U.S.C.A. § 79z-5a was originally enacted (October 24, 1992), these generating facilities cannot be considered "eligible facilities" for EWG purposes unless the Commission makes a specific determination that allowing the facilities to be deemed eligible facilities (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law. 15 U.S.C.A. § 79z-5a(c).

headquarters of each of these entities; (iii) and the names and addresses of the officers and directors of each of these entities.⁴ Once this information is known, the Company states it will then provide it to the Commission. The foregoing information is required under 20 VAC 5-202-40 B 4. Thus, the Company has requested a waiver with respect to filing this information at this time.

The Company states that it has not developed an estimate of the cost of its proposed Plan, but expects to incur costs that generally will fall into the following three categories:

- Costs incurred to develop the corporate separation plan;
- Capitalization costs; and
- Costs incurred to transfer assets and liabilities to Genco.

The costs incurred to develop the corporate separation plan may, according to the Company, include investment banking fees, legal fees, system conversion costs, accounting fees, and other such costs.

The Company further states that capitalization costs with respect to the Plan's implementation include rating agency fees, advisory and consultation fees, securities registration fees, underwriting fees, refunding costs, legal fees, and other issuance expenses. The costs incurred to transfer assets and liabilities to Genco are said to include property transfer costs, permit fees, license fees, taxes, legal fees, and accounting fees. The Company has requested a waiver of the Commission's requirement in 20 VAC 5-202-40 B 3 a that an estimate of the costs of its proposed corporate separation plan be contained in this filing.

In addition, the Company states in its application that if it is unable to proceed with the corporate separation plan outlined in its application, it may effect an alternative corporate restructuring

⁴ The current officers and directors of AEP-VA, which may change upon implementation of the Plan, are shown on Exhibit C-4.

whereby the transmission and distribution assets and operations would be transferred out of AEP-VA, while AEP-VA would retain the generation assets and operations. The Company provided no further explanation about this alternative plan for corporate separation.

Financing

The Plan proposes that the Genco will be formed by a tax-free distribution of Genco's stock from AEP-VA to AEP. Changes in the debt structure of the various entities involved will be necessary. The Company seeks approval to engage in non-specified offerings and agreements to accomplish this.

By way of background, the Company states that it had approximately \$1.6 billion in long term debt outstanding as of December 31, 1999. By year-end 2000, AEP-VA's long-term debt was projected to be as follows:

	<u>Amount (\$millions)</u>
First mortgage bonds	\$743.9
Senior Notes	468.0
Tax exempt financing	234.8
Jr. Subordinated Notes	<u>161.3</u>
	<u>\$1,608.0</u>

The Company asserts that to separate its assets into two different legal entities, it will be necessary for AEP-VA to redeem portions of its debt and for Genco to issue debt; additionally, the Company says that it may pursue receiving required bondholder consents to transfer a portion of AEP-VA's existing debt to Genco. The redemption, refinancings and/or transfer of debt will occur in conjunction with the transfer of the generating assets from AEP-VA to Genco. The capitalization of AEP-VA and Genco would proceed with a ratings goal of Baa1/BBB+ for AEP-VA and an investment

grade rating for Genco. AEP-VA currently has credit ratings of A3 and A from Moody's Investors Service and Standard and Poor's, respectively.

Substantially all of the assets of AEP-VA are said to be subject to the lien of its mortgage bond indenture and AEP-VA has covenant obligations in that indenture and other of its financings. In order to transfer the generation assets and operations out of AEP-VA, but remain in compliance with these obligations, AEP-VA proposes to undertake debt restructuring actions, which may include open market purchases of debt obligations, defeasance, exchange for alternative security, tendering of securities, and trustee or bondholder consents.

The Company further states that after the transfer of the generation assets from AEP-VA to Genco, all existing AEP-VA debt would remain the obligation of AEP-VA. The Company proposes to employ a combination of debt restructuring initiatives in order to achieve the target ratings objectives including redemptions, debt assumption agreements and, if possible, debt exchange agreements.⁵

According to the Company, achieving the credit ratings targets it identifies will depend not only on the degree of financial leverage of the various entities, but also on measures of cash flow coverage. The extent of the recapitalization will therefore be significantly affected by the level and predictability of revenues to be received by each of the entities, as well as the operational expenses of each. For these reasons, according to the Company, it is not possible to predict the level of debt at each of the entities (AEP-VA and Genco), or the precise form that the debt will take. Similarly, according to the Company, it is not possible to provide the capital structure and cost of capital of AEP-VA and Genco

⁵ With respect to the tax-exempt obligations of AEP-VA, it is the stated intent of the Company to effect the transfer of these, or replacement obligations, to Genco, either by assumption or issuance of refunding obligations. According to the Company, debt assumption agreements could be effected to the extent permitted by applicable financings, and in a manner so as not to create a potential future tax obligation, with Genco undertaking to assume and discharge certain debt obligations that would nominally remain liabilities of AEP-VA.

resulting from the Plan, as required by 20 VAC 5-202-40 B 3 a. The Company asserts that this information (the capital structure and cost of capital of AEP-VA and Genco) is and will remain unknown until after the Plan is approved and implemented. Therefore, the Company has requested a waiver of the Commission's requirement in 20 VAC 5-202-40 B 3 a that this financial information be included in the Company's filing.

Accordingly, at this time, the Company seeks the Commission's authorization to engage in non-specified exchange offerings and debt assumption agreements to the extent necessary to achieve, as closely as possible, the credit ratings targets for the recapitalization of AEP-VA and Genco, as outlined above.⁶

Capped Rate and Default Service

The Company states in its application that it is preparing contracts to ensure the provision of capped rate and default service obligations. Information pertaining to this obligation is required under 20 VAC 5-202-40 B 6 g and h. The Company proposes that following implementation of the Plan, AEP-VA will retain the obligations of an incumbent electric utility as provided in the Act. These obligations include the provision of generation service to all retail customers in AEP-VA's service territory that are served under capped rates pursuant to § 56-582, and those assigned to AEP-VA for any portion of default service, if AEP-VA is named a provider of default service in accordance with § 56-585.

The Company acknowledges that even though AEP-VA would not own or operate any generating assets once the Plan is implemented, it would be required, pursuant to the Act, to ensure that

⁶ The Company states that it will request approval, pursuant to §§ 56-55 through 56-75 of the Code of Virginia, for intercompany and restructured financing arrangements following approval of the Plan, as necessary.

adequate generation and generation-related services are available to meet its capped rate service and its default supply obligations, if any, established under the Act, in accordance with all other state and federal regulations. To accomplish these objectives, upon implementation of the Plan, one or more contractual arrangements will be in place. According to the Company, these contractual arrangements are currently being prepared, and it was expected that they would be available by April 2, 2001. The Company subsequently requested an extension until May 31, 2001, to file the information.

Thus, AEP-VA requests a waiver of the Commission's requirement, in 20 VAC 5-202-40 B 6 g and h, that it explain how these above-described contractual arrangements between AEP-VA and Genco will enable AEP-VA to satisfy any obligation it may have to provide capped rate service and default service.

Fuel Cost Recovery

AEP-VA is not requesting any change in its fuel cost recovery mechanism at this time. However, the Company desires to reserve the right to amend its filing in the future with regard to fuel cost recovery. Specifically, the Company states that the current fuel factor methodology requires the use of, among other things, actual fuel expenses associated with the generation of electricity to serve native load customers. However, it notes that as restructuring of the electric industry progresses, such costs will generally be considered proprietary. In addition, says AEP-VA, there will be incentives for Genco to serve all of its customers' load, including any load of AEP-VA's customers, using the most economic resources available, including its previously regulated and any previously unregulated generation resources. Further, the separate tracking of fuel costs associated with providing native load customers with bundled service and fuel costs associated with providing "competitive" or non-native

load customers with generation service only will become increasingly more complex and difficult, if not impossible, according to the Company.

The Company states that it is working on these issues as part of the development of the contractual arrangements AEP-VA proposes for purposes of satisfying capped rate and default service obligations. AEP-VA declares that it is not requesting to change its fuel factor or the current fuel factor methodology at this juncture. However, AEP-VA states that it reserves the right to amend its filing in this regard at the time it submits the assessments referenced above.

Rate Unbundling

The Company proposes to unbundle rates into generation, transmission, distribution and other competitive services. As part of its application, the Company provided 1996 and 1999 cost of service studies. The Company asserts that the 1996 study, resulting from the settlement of the Company's last rate case, should be the basis for unbundling rates in this proceeding. Moreover, the Company proposes to freeze the availability of certain rate schedules that, it states, are inconsistent with customer choice.

The Company states that as required by 20 VAC 5-202-40 B 7 a,⁷ a 1999 Class Cost of Service Study ("COSS") was provided in Exhibit F-2 annexed to the application, solely to comply with the Commission's filing requirements. The Company asserts that such study is not appropriate for use in unbundling AEP-VA's current rates, which are based upon a 1996 Class COSS. Consequently, the Company has not made any adjustments, such as various revenue and cost adjustments related to year-end number of customers by class or the typical growth adjustment, that would be necessary to make

⁷ The application refers to 20 VAC 5-202-40 B 7 c, which the Commission believes is a typographical error.

this 1999 Class COSS appropriate for rate design and rate unbundling purposes. The Company has instead unbundled its current rates based upon the 1996 Settlement Class COSS on which current rates are based.

Tariffs

The Company also seeks under its Plan the Commission's approval of AEP-VA's proposed Standard Tariff and Open Access Distribution Tariff ("OAD Tariff"). The Company filed both bundled and unbundled tariffs. According to the Company's application, service under the Standard Tariff is comparable to the Company's current bundled rate service and will apply to those customers who do not choose an alternative supplier of energy services. The Company explained that the OAD Tariff is to apply to customers who choose an alternative supplier of energy services; the OAD Tariff also includes provisions for those suppliers of such services.

The Company indicates its Standard Tariff includes modifications to its current bundled Terms and Conditions of Service and Rate Schedules, and includes new provisions. The Standard Rate Schedules include unbundled rates for Generation, OATT Transmission, Retail Transmission and Distribution. Customers who take Standard Service from AEP-VA will pay all of these components to AEP-VA.

The OAD Tariff comprises entirely new documents. According to the Company's application, the major provisions of the Terms and Conditions of the OAD Tariff relate to a customer's initial choice of an alternative supplier of electric energy, the manner of changing suppliers, terms for return to Standard Service, along with provisions for transmission service, losses, metering and load profiling, and treatment of partial payments. The OAD Terms and Conditions of Service contain a minimum stay provision that the Company believes is necessary to prevent gaming by Energy Service Providers and

customers. A customer who takes competitive service from an alternative supplier would have to subscribe to AEP-VA service for at least 12 consecutive months if the customer desired to return to AEP-VA service. According to the Company, this requirement will help prevent "seasonal gaming" by customers who might otherwise choose to purchase generation services from a competitive supplier during low-cost months (i.e., non-summer), returning to the utility for capped rate service during high cost months (i.e., summer).

The second item of the OAD Tariff is the Supplier Terms and Conditions of Service. The Company indicates that the Supplier Terms and Conditions of Service contain provisions applicable to all persons and entities that supply or offer to supply competitive retail electric service to customers taking distribution service from AEP-VA, including alternative suppliers of energy services, alternative suppliers of other competitive services and aggregators.

Wires Charges

According to the Company, accounting for the wires charges is dependent on contractual agreements ultimately entered into between AEP-VA and Genco. Specifically, the Company states that the actual wires charges to be included in AEP-VA's unbundled rates will be calculated prior to January 1, 2002, to reflect changes in market prices for generation as approved by the Commission for service on and after January 1, 2002. The wires charges will be subject to adjustment thereafter, until July 1, 2007, in accordance with §§ 56-582 and 56-583 of the Act. According to the Company, both the initial and adjusted wires charges will reflect any changes in AEP-VA's fuel factor that may occur under the provisions of § 56-249.6.

However, the Company states that its accounting of any wires charges, as well as any impact upon its financial statements, is dependent upon the contractual arrangements ultimately entered into by

AEP-VA and Genco. Thus, the Company has requested a waiver of the Commission's requirement that this accounting information be submitted at this time.

Compliance with Act

The Company states that the Plan complies with Act requirements concerning relations between functionally separated and affiliated entities. The Plan provides for the legal separation of AEP-VA's generation assets and operations from the transmission and distribution functions through formation of separate entities to perform the generation functions and the transmission and distribution functions. Further, the Company emphasizes, the Plan provides for the separation of employees performing generation activities from employees performing the transmission and distribution activities. The books and accounting records of Genco, the generation affiliate, will be separate from the books and accounting records of AEP-VA, the transmission and distribution company. The Company states in its filing that until such a corporate separation is accomplished, AEP-VA will functionally separate as necessary to comply with 20 VAC 5-202-30.

With respect to the provisions of 20 VAC 5-202-30 B 4 (requiring internal controls with regard to information sharing between affiliated entities), for example, the Company has furnished a listing of internal controls, which is set forth in Exhibit D annexed to the Company's application, to be implemented by AEP-VA pursuant to 20 VAC 5-202-30 B 4 b. According to the Company, any modifications to such controls will be filed with the Commission as specified in the rule.

Waivers Sought

The Company seeks waiver of the following information it is otherwise required to provide under the Commission's functional separation rules:

- The estimated cost of the Plan (20 VAC 5-202-40 B 2 b (5)).
- Capital structure information for AEP-VA and Genco (20 VAC 5-202-40 B 3 a).
- Distinct cost of service studies separating AEP-VA operations into total Company and total Virginia operations and separating total Virginia operations into jurisdictional and non-jurisdictional operations (20 VAC 5-202-40 B 7).⁸
- An assessment of how proposed contractual arrangements between AEP-VA and Genco will satisfy the Company's obligation to provide capped rate and default service (20 VAC 5-202-40 B 6 g and h). Related waivers are requested, including accounting information pertaining to proposed wires charges. The Company had initially proposed that such information not be required from it until April 2, 2001; now, the Company has expressed its desire that this deadline be pushed back to May 31, 2001.

Approvals Sought

In summary, the Company seeks the following: (i) approval of its transfer of assets under the Utility Transfers Act and under § 56-590 of the Restructuring Act; (ii) approval of its bundled and unbundled tariffs; (iii) all other approvals required under §§ 56-76 through 56-87, 56-88 through 56-92, and 56-590; and (iv) issuance of the findings required by PUHCA pertaining to the transfer of the Company's generation assets to an exempt wholesale generation company. In addition, as noted above, the Company also requests a number of waivers.

⁸ According to the Company, its filed cost of service studies accomplish these steps in one study.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion that notice should be given of the Company's filing in this matter, that interested parties should have the opportunity to comment or participate as Protestants, and that a hearing should be scheduled in this proceeding.

Section 56-590 B 2 requires the Commission to "direct the functional separation of generation, retail transmission and distribution of all incumbent electric utilities . . . to be completed by January 1, 2002."⁹ This functional separation may be accomplished through the creation of new affiliated separate corporations into which assets may be divested, by means of the establishment of separate divisions within a company to manage the generation, transmission, and distribution functions separately, or by other means including outright sale of assets to third parties. AEP-VA has proposed the first method of accomplishing its functional separation, but has advised us it is unable now to provide significant amounts of data necessary for our consideration of its proposal.

Specifically, although the Company has indicated that certain assets will be transferred, it has not provided the anticipated capital structure of any of the proposed new and remaining entities. Moreover, the Company states that the capital structure of these entities will not be known until after it receives its anticipated Commission approval of its corporate separation plan. Further, the Company has only provided a broad outline of how it will meet its capped rate and default service obligations without providing any detail of its contractual arrangements for such services. The Company also has not provided the basis for the continued collection of the fuel component of its rates upon the intended transfer of all of its generation assets. The Company also has not explained the basis upon which it intends to calculate wires charges when the Company will no longer operate as a generation company.

⁹ We interpret "to be completed by January 1, 2002," to refer to our obligations under the section to direct the separation and not to those of the incumbent utilities to complete the separation so directed.

Finally, the Company has briefly stated, without further detail, support, or explanation, that it may effect an alternative corporate restructuring if it is unable to proceed with its proposed corporate separation plan as outlined in its application. In connection with this proposal, the Company has not explained how it will meet its capped rate and any default service obligations under the Restructuring Act if it transfers away its transmission and distribution assets and operations and will no longer be serving as the incumbent electric utility in its certificated service territory.¹⁰ If the Company decides to pursue this corporate separation alternative, it will need to file information in support of this alternative plan, which satisfies the Restructuring Act's requirements, any other applicable provisions under the Virginia Code and the Commission's rules for functional separation.

This lack of critical fundamental information is not entirely unexpected, given the magnitude of the Company's proposed restructuring. We direct the Company to continue to develop all information necessary for our full consideration of its proposed plan and to supply the data as quickly as it becomes available.

While this effort is underway, however, time continues to pass and the statute obligates us to direct some form of functional separation by year's end. Accordingly, we direct the Company to provide us now with information sufficient for development and consideration of functional separation by divisions that does not involve the much more complex corporate separation the filed plan envisions.

¹⁰ The capped rate provisions of the Restructuring Act, Va. Code § 56-582, require each incumbent electric utility, consistent with its approved functional separation plan, to provide bundled electric service to customers in its certificated service territory until capped rates are terminated. Incumbent electric utility is defined in the Restructuring Act as "each electric utility in the Commonwealth that, prior to July 1, 1999, supplied electric energy to retail customers located in an exclusive service territory established by the Commission." As of July 1, 1999, AEP-VA was the incumbent electric utility providing electric service in its exclusive service territory. Furthermore, the default service provisions in the Act, Va. Code § 56-585, provide that the Commission may require a distributor, or its affiliate, to provide one or more components of default service. A distributor is defined in the Act as "a person owning, controlling, or operating a retail distribution system to provide electric energy directly to retail customers."

The Company has already said, as noted above, that it intends to separate functionally until it can accomplish a corporate separation (providing, of course, that we find such proposal fulfills the public interest). Many of the functions may already be separated in the current operational structure of the Company.

Our consideration of this divisional plan, as it were, will continue in tandem with our consideration of the Company's more ambitious proposal to effect a complete corporate affiliate restructuring. If we are able to render an informed judgment as to the merits of the latter by January 1, 2002, we will do so. If not, we will still be able to discharge our obligations under the law at that time by directing, if we find appropriate, functional separation that does not involve divestiture of assets to other corporate entities that may or not be affiliates of the Company.

All information necessary to consider fully functional separation by divisions shall be filed as soon as possible, but not later than May 15, 2001. The filing shall comply with all requirements in the Restructuring Act and the Commission's rules for functional separation, 20 VAC 5-202-10 et seq. (the "Rules"). The filing shall also include any additional information that may be required as a result of the 2001 General Assembly's passage of Senate Bill 1420.

Accordingly, the Commission will consider the Company's plan for corporate separation in pace with its consideration of the filing relating to functional separation by divisions. AEP-VA shall continue to develop and present, as available, information regarding its proposal for corporate separation that is necessary for compliance with the requirements of our Rules. Furthermore, the Commission will consider all additional information that the Company may in its discretion provide in further support of the Company's plan for corporate separation.

The Commission has also reviewed the Company's requests for waivers of the following filing requirements under the Commission's functional separation rules: (i) requirement to provide estimated cost of the proposed plan of functional separation; (ii) requirement to provide capital structure information for AEP-VA and Genco; (iii) requirement to provide distinct cost of service studies separating AEP-VA's operations into total Company operations and total Virginia operations, and separating total Virginia operations into jurisdictional and non-jurisdictional operations; and (iv) requirement to provide an assessment of how proposed contractual arrangements between AEP-VA and Genco will satisfy the Company's obligation to provide capped rate and default service (20 VAC 5-202-40 B 6 g and h), together with related waivers, including the requirement to provide accounting information pertaining to proposed wires charges.

We will deny the Company's waiver request concerning an estimate of the cost to functionally unbundle. We believe this information is necessary to the Commission in obtaining a complete understanding of the Company's proposal and to fulfill its statutory obligations. The Company shall provide this information in relation to its plan for corporate separation as soon as it is available. Furthermore, the Company shall provide this information for purposes of its functional separation filing by divisions not later than May 15, 2001.

The Company's requested waiver of the requirement to provide the capital structure and cost of capital for AEP-VA and Genco resulting from the plan is granted in part. While we understand that the specific capital structure components, dollar levels, and cost rates may be largely unknown until later, this information is important. The Company shall provide this information as soon as it is available. Further, any capitalization information supporting the assumptions of the Plan, including target capitalization ratios, shall be provided to Staff and interested parties upon request under the

Commission's discovery rules. In addition, this partial waiver shall apply only to this corporate separation application and shall not have any impact on the provision of capitalization information in future Earning Test filings. Also, the Company shall provide this information in connection with its filing relating to functional separation by divisions not later than May 15, 2001.

We will grant the Company's request for a waiver with respect to the provision of distinct cost of service studies that separate total operations into total Company operations and total Virginia operations and that separate total Virginia operations into Virginia jurisdictional and Virginia non-jurisdictional operations. The study contained in the Company's filing combines the two studies specified in 20 VAC 5-202-40 B 7 a and b, providing the required information in a single study.

With regard to the Company's request for a waiver and further extension to provide an assessment of how proposed contractual arrangements between AEP-VA and Genco will satisfy the Company's obligations to provide capped rate and default service, the Company shall provide this information to the Commission in support of its plan for corporate separation as soon as it is available. The Company's waiver request also relates to accounting information pertaining to proposed wires charges. Accordingly, in relation to the Company's corporate separation filing, such information shall also be provided to the Commission when it is available. The Company shall, however, file on or before May 15, 2001, an assessment of how the Company will satisfy obligations to provide capped rate and default service with its filing relating to functional separation by divisions.

Additionally, we note that the Company has developed its unbundled rates based on its 1996 Class COSS rather than its 1999 Class COSS. Such an approach may fail to reflect changing cost relationships between the various functions. We, therefore, will direct the Company to submit a 1999 Class COSS and resulting unbundled rates with its testimony that will be filed May 29, 2001. The

Company should consult with the Commission Staff as to how to resolve issues associated with differences between the updated COSS and the COSS upon which current rates were originally based.

Finally, as part of the procedural schedule established herein, we will direct the Staff to convene a meeting or meetings among the Company, the Office of the Attorney General (should that office participate herein), all Protestants, and Staff for the purpose of identifying and discussing the issues raised by this application and exploring the possibility of narrowing the issues to be presented at hearing through settlement or stipulation. The Staff counsel assigned to this case will be directed to advise the Commission, by letter, of the results of these discussions. Accordingly,

IT IS ORDERED THAT:

- (1) This matter is docketed and assigned Case No. PUE010011.
- (2) A public hearing on this matter is hereby scheduled for October 29, 2001, commencing at 10:00 a.m. in the Commission's Second Floor courtroom, Tyler Building, 1300 East Main Street, Richmond, Virginia.
- (3) The Company shall make its Plan for corporate separation, together with its filing relating to functional separation by divisions, available to the public, who may obtain a copy of this application by requesting it in writing from AEP-VA's Counsel, Anthony Gambardella, Esquire, Woods, Rogers & Hazlegrove, 823 East Main Street, Suite 1200, Richmond, Virginia 23219, or who may inspect the Plan and the filing relating to functional separation by divisions, and all materials the Company may subsequently file in this proceeding during regular business hours at the Company's business office located at 40 Franklin Road, S.W., Roanoke, Virginia 24022, or during regular business hours at the State Corporation Commission, Document Control Center, First Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia.

(4) On or before May 15, 2001, the Company shall file all information necessary to consider fully functional separation by divisions. The filing shall comply with all requirements in the Restructuring Act and the Commission's rules for functional separation, 20 VAC 5-202-10 et seq. and shall include any other information necessitated by the 2001 General Assembly's passage of Senate Bill 1420.

(5) On or before May 29, 2001, the Company shall file (i) its prefiled testimony in support of its corporate separation included in its application and in support of the functional separation by divisions required to be filed herein, (ii) the 1999 Class COSS and unbundled rates based on such study, and (iii) all other information and data upon which the Company relies in support of its application herein.

(6) When available the Company shall file all information required to complete the corporate separation portion of its application as directed herein, together with any amendments to the Plan necessitated by the 2001 General Assembly's passage of Senate Bill 1420.

(7) Any interested person desiring to participate as a Protestant in this matter shall file a notice of protest on or before June 5, 2001, concurrently serving copies thereof on counsel for the Commission Staff, and counsel for the Company. An original and fifteen (15) copies of any such notice of protest shall be filed by June 5, 2001, with the Clerk of the Commission, P.O. Box 2118, Richmond, Virginia 23218, and shall refer to Case No. PUE010011.

(8) Staff shall convene a prehearing conference of the parties on or before July 13, 2001, and thereafter as the Staff and parties find desirable, to explore the possibility of narrowing the case through stipulation or settlement of particular issues.

(9) Staff counsel shall advise the Commission, by letter, of results of the prehearing conference(s) on or before August 14, 2001.

(10) On or before August 29, 2001, any interested person desiring to comment on the Company's corporate separation Plan and its filing related to functional separation by divisions shall file an original and fifteen copies of any such comments with the Clerk of the Commission, P.O. Box 2118, Richmond, Virginia 23218, and shall refer therein to Case No. PUE010011. Such persons shall concurrently serve copies of any such comments on counsel for the Commission Staff, counsel for the Company, and upon any protestants herein.

(11) On or before September 7, 2001, any Protestant shall file an original and fifteen (15) copies of any such protest and any prefiled testimony with the Clerk of the Commission and shall concurrently serve copies thereof on counsel for the Commission Staff, counsel for the Company, and on other protestants herein.

(12) The Commission Staff shall review the proposed corporate separation Plan and the filing related to functional separation by divisions, and on or before September 21, 2001, shall file with the Clerk of the Commission an original and fifteen (15) copies of its prefiled testimony concerning the same and shall concurrently serve a copy thereof on counsel for the Company and any Protestants.

(13) On or before October 1, 2001, the Company shall file with the Clerk of the Commission an original and fifteen (15) copies of its rebuttal testimony and shall concurrently serve a copy thereof on counsel for the Commission Staff and any Protestants.

(14) The Company and any other parties shall respond to interrogatories and data requests within ten (10) calendar days of service. Exceptions to any such interrogatories or data requests shall be filed within seven (7) calendar days of service. Except as otherwise modified herein, discovery shall be in accordance with Part VI of the Commission's Rules of Practice and Procedure.

(15) Pursuant to Rule 7:1 of the Commission's Rules of Practice and Procedure, a hearing examiner is hereby appointed to adjudicate any disputes concerning interrogatories, data requests, or any other discovery requested or made in this proceeding. Any such adjudication shall be made expeditiously with due regard to the timetable for this proceeding established by this Order.

(16) With respect to the Company's requests within its application herein for waivers of certain provisions of the Commission's functional separation rules, the Commission hereby: (i) Denies the Company's waiver request concerning an estimate of the cost to functionally unbundle. Such information relating to the Company's plan for corporate separation shall be provided once it is available. The Company shall file such information in its filing relating to functional separation by divisions by May 15, 2001. (ii) Grants in part the Company's requested waiver of the requirement to provide capital structure and cost of capital information for AEP-VA in support of its plan for corporate separation. Such information relating to the Company's plan for corporate separation shall be provided once it is available. However, any capitalization information supporting the assumptions of the plan for corporate separation shall be provided to interested parties upon request under the Commission's discovery rules. Further, the Company shall provide capital structure and cost of capital information related to functional separation by divisions not later than May 15, 2001. (iii) Grants the Company's request for a waiver with respect to the provision of distinct cost of service studies that separate total operations into total Company operations and total Virginia operations and that separate total Virginia operations into Virginia jurisdictional and Virginia non-jurisdictional operations. (iv) Grants, in part, the Company's request for a waiver and further extension to provide an assessment of how proposed contractual arrangements between AEP-VA and Genco will satisfy the Company's obligations to provide capped rate and default service as the information relates to its application for corporate

separation. The Company shall provide this information to the Commission as soon as it is available.

Furthermore, the Company shall include in its filing relating to functional separation by divisions, due by May 15, 2001, an assessment of how it will satisfy its obligations to provide capped rate and default service.

(17) On or before April 27, 2001, the Company shall cause the following notice to be published as display advertising (not classified) in newspapers of general circulation in its Virginia service territories:

NOTICE TO THE PUBLIC OF AN APPLICATION
BY APPALACHIAN POWER COMPANY D/B/A
AMERICAN ELECTRIC POWER-VIRGINIA
FOR APPROVAL OF A PLAN TO SEPARATE ITS
GENERATION, TRANSMISSION AND DISTRIBUTION
ASSETS AND ACTIVITIES
CASE NO. PUE010011

On January 3, 2001, Appalachian Power Company d/b/a American Electric Power-Virginia ("AEP-VA" or the "Company") filed an application with the Virginia State Corporation Commission ("the Commission"), pursuant to Virginia Code § 56-590 B of the Virginia Electric Utility Restructuring Act ("Restructuring Act" or "the Act"), for approval of a plan for the corporate separation of its generation, transmission and distribution assets, and activities (the "Plan"). By order dated April 11, 2001, the Commission directed the Company to also file with the Commission, as soon as possible but not later than May 15, 2001, all information necessary to consider fully functional separation by divisions, together with any other information necessitated by the 2001 General Assembly's passage of Senate Bill 1420. The filing shall comply with all requirements in the Restructuring Act and the Commission's rules for functional separation.

Under the Plan the Company proposes to structurally separate its functions by transferring its generation assets to a new generation company, referred to as "Genco" in the Company's application. AEP-VA proposes to distribute the stock of Genco to its parent company, American Electric Power Company, ("AEP") in a tax-free spin-off. AEP-VA would retain its transmission and distribution assets and

operations. According to the Company, it would operate its transmission and distribution facilities as functionally separate business units.

As proposed under its Plan, AEP-VA would no longer own any electric generation assets but would purchase all power to serve its customers from Genco and/or its other affiliates. To ensure that adequate generation and generation-related services are available to meet its capped rate service and any default service obligations, AEP-VA proposes that one or more contractual arrangements, which are currently being prepared and have not yet been filed with the Commission, will be in place. Moreover, AEP-VA is not requesting any change in its fuel cost recovery mechanism at this time, but the Company desires to reserve the right to amend its filing in the future.

Essentially all of AEP-VA's assets are subject to the lien of its mortgage bond indenture, and the Company has covenant obligations in that indenture and other of its financings. Following the transfer of AEP-VA's generation assets to Genco, all of AEP-VA's current outstanding long-term debt (approximately \$1.6 billion), would nevertheless remain the obligation of AEP-VA. The Company proposes to then reallocate the debt between the Company and Genco. In order to reallocate debt and to transfer the generation business out of AEP-VA in compliance with its obligations, the Company proposes to undertake debt-restructuring actions. These actions, according to the Company, may include market-based purchases of debt obligations, defeasance, alternative security, and trustee or bondholder consents. If the Company is unable to proceed with the restructuring approach outlined, the Company may propose a different functional separation: transferring AEP-VA's transmission and distribution assets from AEP-VA, while AEP-VA would retain the generation assets.

The Company's Plan further proposes that following its functional separation, AEP-VA will collect any wires charges due from retail customers. AEP-VA would also be responsible for providing retail customers with capped rate service until July 1, 2007 (or until any earlier date that capped rates are terminated pursuant to the Act); it also will provide default service under the Act, if it is designated a default service provider.

As required by the Commission's functional separation rules, the Company proposes in its Plan to unbundle its rates to reflect the separation and deregulation of its generation business. The Company

provided 1996 and 1999 cost of service studies in support of its unbundled rates. The Company asserts in its application that the 1996 study, resulting from the settlement of the Company's last rate case, should be the basis for its unbundled rates in this proceeding. The Company provided unbundled rates based upon the 1996 study.

The Company also seeks approval of two sets of tariffs filed with its application. The Company filed a Standard Tariff the Company states will apply to customers who under competition do not choose an alternative supplier of energy services. The second tariff, the Open Access Distribution or "OAD" Tariff, is to apply to customers who choose an alternative supplier of energy services, and includes provisions for those suppliers of such services. One item of the OAD Tariff is the Supplier Terms and Conditions of Service. The Company indicates that the Supplier Terms and Conditions of Service contain provisions applicable to all persons and entities that supply or offer to supply competitive retail electric service to customers taking OAD Service from AEP-VA, including alternative suppliers of energy services, alternative suppliers of other competitive services and aggregators.

Significantly, the proposed OAD Tariff also includes a "minimum stay" period of twelve months for those customers who return to the Company for capped rate generation service following such customers' switching to competitive suppliers. That is, a customer who takes competitive service from an alternative supplier would have to subscribe to AEP-VA service for at least 12 consecutive months if the customer desired to return to AEP-VA service. According to the Company, this requirement will help prevent "seasonal gaming" by customers who might otherwise choose to purchase generation services from a competitive supplier during low-cost months (i.e., non-summer), returning to the utility for capped rate service during high cost months (i.e., summer).

AEP-VA has also requested Commission findings relative to approvals it seeks under federal law concerning the proposed transfer of its generating assets and operations to Genco, an entity that will be engaged in the sale of electricity within the wholesale market and not subject to regulation by the Virginia State Corporation Commission. Specifically, under the federal Public Utility Holding Company Act of 1935 ("PUHCA"), the Commission must find that the proposed generation assets and operations transfers (i) will benefit consumers, (ii) are in the public interest, and (iii) do not violate State law.

The Company is also asking for an additional Commission finding under PUHCA concerning the proposed purchase power agreement between AEP-VA and Genco. Under PUHCA provisions, AEP-VA and Genco cannot enter into a wholesale power purchase agreement unless this Commission makes a determination that the Commission has sufficient regulatory authority, resources, and access to books and records of AEP-VA and any relevant associate, affiliate, or subsidiary company to exercise its duties under 15 U.S.C.A. § 79z-5a(k)(2) (1997). Those duties, imposed upon the Commission by federal law, require the Commission to determine that the proposed transaction (i) will benefit consumers, (ii) does not violate any state law (including where applicable, least cost planning), (iii) would not provide Genco any unfair competitive advantage by virtue of its affiliation or association with AEP-VA, and (iv) is in the public interest.

Thus, as set forth above, the Company requests approval of the Plan, including the following: (i) approval of its transfer of the generation assets and operations; (ii) approval of its bundled and unbundled tariffs; (iii) issuance of necessary findings as required by the Public Utility Holding Company Act; and (iv) any other approvals under §§ 56-76 to -87, 56-88 to -92, 56-582(E), and 56-590(B) of the Code of Virginia.

A public hearing on this matter before the Commission has been scheduled for October 29, 2001, to commence at 10:00 a.m. in the Commission's Second Floor Courtroom, Tyler Building, 1300 East Main Street, Richmond, Virginia, for the purpose of receiving evidence related to the Company's functional separation Plan and its filing relating to functional separation by divisions. Any person desiring to make a statement at the hearing should appear in the Commission's courtroom at 9:45 a.m. on the hearing date and identify himself or herself to the bailiff as a public witness. Individuals with disabilities who require an accommodation to participate in the hearing should contact the Commission at 1-800-552-7945 (voice), or 1-804-371-9206 (TDD) at least seven days before the scheduled hearing date.

A copy of the Company's functional separation Plan and, when filed, the filing relating to functional separation by divisions, are available for public inspection between the hours of 8:15 a.m. and 5:00 p.m. in the Commission's Document Control Center located on the first floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia, and at AEP-VA's business office located at 40 Franklin Road, S.W.,

Roanoke, Virginia 24022, during regular business hours. The application may also be requested in writing from AEP-VA's counsel, Anthony Gambardella, at Woods, Rogers & Hazlegrove, 823 East Main Street, Suite 1200, Richmond, Virginia 23219.

The Commission encourages the participation of the public in this important proceeding. Any interested person desiring to file a notice of protest and protest concerning the Company's Plan and/or the filing relating to functional separation by divisions shall file (i) any such notice of protest by June 5, 2001, and (ii) any protest and any prefiled testimony on or before September 7, 2001. Additionally, any person desiring to file comments concerning the Company's proposed Plan or filing relating to functional separation by divisions shall file comments thereon on or before August 29, 2001.

An original and fifteen (15) copies of comments or of any notice of protest and protest, prefiled testimony, or other written communications concerning AEP-VA's functional separation application shall be filed with the Clerk of the Commission, P.O. Box 2118, Richmond, Virginia 23218, referring to Case No. PUE010011, and shall also be served on AEP-VA's counsel at the address noted above.

Interested persons may obtain a copy of the Commission's Order for Notice and Comment, establishing the proceeding in this matter and setting forth the complete procedural schedule applicable thereto, from the Commission's Web site, <http://www.state.va.us/scc/caseinfo/orders.htm>, or by directing a written request for a copy of the same to Joel H. Peck, Clerk of the Commission, at P.O. Box 2118, Richmond, Virginia 23218, referring to Case No. PUE010011.

AMERICAN ELECTRIC POWER-VIRGINIA

(18) On or before April 27, 2001, the Company shall serve a copy of this Order upon governmental entities within its service territories as follows: (i) upon the Chairman of the Board of Supervisors of any county, (ii) upon the mayor or manager of any county or city, or (iii) upon officials comparable to the foregoing within counties, cities, or towns having alternate forms of governments.

Service shall be made by first-class mail, or by delivery to the customary place of business or the residence of the person served.

(19) On or before May 25, 2001, the Company shall file with the Clerk of the Commission proof of the notice and service required by ordering paragraphs (17) and (18).

(20) This matter is continued for further orders of the Commission.